

OIL AND GAS AUTHORITY – UK PETROLEUM LICENSING: FINANCIAL GUIDANCE

The measures described in this guidance are solely for the purpose of establishing whether Licensees have the viability and capacity to undertake the obligations of their Licence. These measures should not be assumed to meet the needs of third parties who have an interest in a Licensee's financial capability.

The OGA has two distinct types of financial criterion: **Financial Viability** and **Financial Capacity**. **Financial Viability** refers to a company's ability to remain solvent while **Financial Capacity** refers to a company's ability to meet known and specific costs.

These tests are undertaken by the OGA, as relevant, at five events in the lifecycle of a licence:

- 1. when awarding a new licence**
- 2. the assignment of any existing licence to a new party**
- 3. when approving a field development plan**
- 4. when consenting to the drilling of an exploration or appraisal well**
- 5. when consenting to the drilling of a development well**

FINANCIAL VIABILITY

1. When considering the award of any licence or the assignment of any existing Licence, the Financial Viability of the licensee afterwards will be one of OGA's criteria in making its decisions. OGA must be confident that each group of companies on a licence is able to continue in sound financial health for the foreseeable future. Each company (even if it is applying for a Promote licence) must therefore demonstrate its basic Financial Viability.
2. A company that meets the following criteria will be deemed to be financially viable:
 - positive Total Net Assets (Shareholders' Funds);
 - a Current Ratio of 1.00 or better;
 - Gross Gearing of 75% or less; and
 - Interest Cover of 2.00 or better.

For the purposes of this process:

Current Ratio = Current Assets/Liabilities Falling Due in Less Than 12 Months

Gross Gearing = Total Debt /Shareholders Funds (expressed as a percentage)

Interest Cover = Operating Profit /(Interest Paid-Interest Received)

3. A company with a deficit of Total Net Assets (Shareholders' Funds) must demonstrate that the deficit is fully funded (e.g. by a corporate parent, directors' or shareholders' loans, commercial debt or other lines of credit) and provide evidence of the funding.
4. A company with a Current Ratio less than 1.00 must demonstrate that its working capital requirements are financed by adequate short term funding arrangements (e.g. by a corporate parent, bank overdrafts, directors loans etc), and must produce evidence of the funding. Arrangements with trade or other creditors are not acceptable because they often imply that a company is in financial difficulty.

5. A company with gross gearing above 75% must demonstrate it will be able to service the debt; i.e. that it can meet the interest payments and any agreed capital repayment schedule.
6. Each company must provide:
 - a. A copy of its most recent published accounts or, if these are not available, a pro-forma balance sheet which has been certified by a director and is sufficiently detailed to enable the Financial Viability Assessment to be undertaken.
 - b. Where a company is reliant on parent company funding, a copy of the corporate parent's most recent consolidated accounts, if these are not available a consolidated pro-forma balance sheet for the corporate parent which has been certified by a director and is sufficiently detailed to enable the financial viability of the corporate group to be assessed.
 - c. Cash flow projections, incorporating a debt repayment schedule as appropriate. For offshore Promote Licence applications or applications for offshore Innovate Licences at either Phase A or Phase B of the Initial Term, these projections should cover a period of at least two years. For all other applications the projections should cover a period of five years.
 - d. Where a company is reliant upon funding from its corporate parent, consolidated cash flow projections should be provided in accordance with sub-paragraph "c" above.
 - e. Evidence of any funding arrangements, for example copies of executed commercial loans/overdraft agreements, director/shareholder loan agreements, parent company loan agreements, parent company guarantee etc.

FINANCIAL CAPACITY

7. When considering: (a) the award of a PEDL, (b) any Seaward Innovate Licence that will open with a 'Phase C' Work Programme, or (c) the assignment of any existing licence other than a Promote Licence in its Promote Period, OGA will consider the Financial Capacity of each company to meet the cost of agreed Work Programmes or other costs necessary to support OGA's objective of MERUK or fulfil their obligations under the licence. OGA will estimate those costs. Where there are none, there will be no Financial Capacity criterion for OGA to apply. For these purposes, all Work Programme costs are included, whether the commitments are firm, contingent or 'drill-or-drop'.

The Criterion

8. OGA requires that each company must demonstrate adequate Financial Capacity to cover its share of known costs (including a Work Programme or proposed Work Programme as appropriate) as well as all of its existing commitments (including overseas commitments). OGA will take into account contingent commitments and drill-or-drop wells as well as firm commitments.
9. OGA requires evidence of 100% funding cover for all FDP, Firm and Contingent Commitments. However, as we recognise that not all Drill or Drop Work Programmes result in the drilling of a well, we do not therefore require 100% funding cover for most Drill or Drop wells in a portfolio; instead a company must demonstrate 100% funding capacity for the single most expensive net well cost exposure, plus 50% of the cost of the others. This includes existing Drill-or-Drop work programme commitments as well as those being applied for. Some existing licences have multi-well Drill-or-Drop Work Programmes; in such cases, OGA will usually consider only the cost of a single well.

The Calculation

Commitment Cover

10. The way in which a company can demonstrate its capacity will vary from one case to the next. Many oil companies have a net worth that is so much greater than the cost of a Work Programme that this alone is enough to assure us that they will be able to raise funding where necessary, or will be able to fund the work from their own internal resources.
11. OGA's primary financial capacity measure is that a Company has Commitment Cover of 2.00 or better where:
$$\text{Commitment Cover} = \frac{\text{Net Worth}}{\text{The sum of existing and proposed licence commitments}}$$
$$\text{Net Worth} = \text{Shareholders' Funds less Intangible Fixed Assets}$$
12. A company with Commitment Cover of less than 2.00 will have to prove its capacity by reference to specific funding arrangements.

Funding Arrangements

13. OGA recognises the flexibility and variety of funding arrangements and we do not want to be prescriptive in this respect. However, some of the ways funding deficits can be met include:
 - **Issue of additional share capital:** Provide details of the proposed share issue, together with documentary evidence that (a) the funds are available and have been irrevocably committed to the share issue by the investor(s), or (b) the share issue has been guaranteed/underwritten by a recognised financial institution or stock brokerage (future share issues will not be acceptable without such evidence). **Arrangements with financial institutions or stock brokerage firms whereby they undertake to raise equity on a "best efforts" basis will not be considered as adequate evidence of funding.**
 - **Parent company loan:** a copy of the executed loan agreement should be provided.

- **Parent company guarantee:** the guarantee should be provided on the parent company's corporate stationery and use one of two prescribed forms of words. Where an applicant seeks to satisfy OGA of its Financial Capacity in this way, besides requiring an parent company guarantee, OGA will apply its financial criteria and documentation/evidence requirements to the parent instead.
 - **Directors' loans:** must be confirmed in writing and the Company must also satisfy OGA about the directors' ability to make such loans from their private resources.
 - **Loans from banks or other financial institutions:** must be evidenced by the provision of a copy of the executed loan agreement. Loan agreements that have been made conditional upon the award of licence are acceptable but letters of intent from a bank or other financial institution are not. If a company will be relying on commercial debt to meet its existing and/or proposed licence commitments, or is a subsidiary of a corporate group which is reliant on commercial debt, OGA will need assurances that the funding arrangements will remain in place long enough to fund the Work Programme and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and agreed capital repayment obligations. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should therefore be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment schedule shows any significant redemption of debt within the next 12 months which cannot be met from operational cash flow, details of how the redemption will be funded should also be provided.
 - **Future cash flows from existing assets:** OGA will require detailed financial projections for a period of not less than 5 years. As a minimum, these projections should comprise cash flow forecasts for both the Applicant Company and consolidated cash flow forecasts for any corporate group to which the Applicant Company may belong. Any assumptions made in the compilation of these forecasts should also be provided. Where companies, or the corporate groups to which they belong, will rely upon the revenue stream of a single asset or upon speculative cash flows, for example where assets are not yet in production, OGA will require adequate contingency funding arrangements to be in place to enable them to meet their licence obligations should the projected cash flows not be achieved.
14. A company must demonstrate adequate Financial Capacity for each application at the time it is made. OGA will **not** defer the Financial Capacity assessment to give the Applicant additional time to put adequate funding arrangements in place once the application has been made. **OGA believes that a responsibly-run company would not knowingly make more applications than it can comfortably demonstrate funding for.**
 15. Note that, where funding is to be supplied by somebody other than the Applicant (e.g. by a parent company), the burden of proving Financial Capacity is logically shifted to that other party. In such a case, OGA cannot consider an application if that other party refuses to divulge the financial information that OGA requires.
 16. Up to the end of a Promote Licence's Promote Period or the beginning of Phase C of a Seaward Innovate Licence, there are no Financial Capacity criteria. However, these criteria are not waived altogether; they are merely deferred until the end of the Promote Period (with a Promote Licence) or the end of whichever Phase comes before Phase C (with an Innovate Licence), and OGA will apply its Financial Viability and Capacity criteria then.. The licence will expire at that time unless the Licensee meets those criteria (among other things). The financial criteria will be those in force for new applications at the time.

LICENCE ASSIGNMENTS

OFFSHORE PROMOTE LICENCES AND OFFSHORE INNOVATE LICENCES AT PHASE A OR PHASE B OF THE INITIAL TERM

17. OGA's policy requirement in this regard is to ensure that an Offshore Promote Licence or an Offshore Innovate Licence at Phase A or Phase B of the Initial Term is only assigned to financially viable companies.
18. OGA will apply the same Financial Viability criteria to the assignment of Promote Licences as it does for the award of new Licences in a Licensing Round.
19. In the period up to the Secretary of State's decision to continue the Promote Licence, which is expressed to happen after two years though the licensee may elect to request it earlier, OGA will not apply any Financial Capacity criteria to assignees.

ALL OTHER LICENCES EXCEPT OFFSHORE PROMOTE LICENCES AND OFFSHORE INNOVATE LICENCES AT PHASE A OR PHASE B OF THE INITIAL TERM

20. OGA's policy requirement in this regard is to ensure that Production Licences are held by companies who are both financially viable and able to meet all their obligations under the Licence, and who have the Financial Capacity to undertake whatever work programme may be agreed. To achieve this, OGA requires that each company must satisfy OGA's Financial Viability criteria and demonstrate it has the Financial Capacity to fund its share of costs of any agreed Work Programme as well as all of its existing commitments (including overseas commitments). For these purposes "Work Programme" means the Initial Term Work Programme, any Programme agreed with OGA under the Fallow Initiative, any Related Work Elements on a Prospective Area or any other commitments that the Licensee may have made to OGA.
21. OGA will apply the same Financial Viability and Financial Capacity criteria to licence assignments as it does for the award of the same type of licence in a Licensing Round.
22. If there is no agreed or assumed work programme or pending FDP, the assignee will not be subject to any Financial Capacity checks but will need to demonstrate financial viability.

INFORMATION AND DOCUMENTATION REQUIREMENTS

23. In some cases, for example following a Licensing Round or earlier licence assignment, OGA may already hold sufficient information for it to be able to assess the assignee's Financial Viability and Financial Capacity. In such cases there is no requirement for the assignee to provide any accounting or other financial information. OGA will be able to advise whether this is the case.
24. Where OGA does not have access to sufficient information to enable it to make a judgement as to the assignee's financial position, it will send a formal request to the assignee asking for such information as it needs to enable such a judgement to be made. This request may include but not be limited to the following:
 - a. An estimate of the assignee's share of any work programme costs
 - b. Full disclosure of the assignee's existing UK and non-UK commitments and associated costs
 - c. If the burden of proving adequate Financial Capacity has been shifted to a corporate parent, the corporate parent must also provide a full disclosure of the Group's UK and non-UK commitments and associated costs.
 - d. One copy of the assignee's recent accounts or financial statements.
 - e. One copy of the most recent group (consolidated) accounts of any body-corporate having ultimate control of the assignee.

- f. Evidence of adequate Financial Capacity.
 - g. If a company will be relying on the financial support of a corporate parent, a parent company guarantee will be required which must be on the corporate stationery of the guarantor and in the prescribed format. (Please note: corporate parents may already have provided a parent company guarantee in favour of the assignee in our preferred, multi-licence format. If this is the case OGA does not require a new parent company guarantee as the existing guarantee will cover the new licence obligations.)
 - h. If a company will be relying upon commercial debt to meet its existing and/or proposed licence commitments, or is a subsidiary of a corporate group which is reliant upon commercial debt, OGA will need assurances that the funding arrangements will remain in place for the foreseeable future and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and any agreed capital repayment schedule. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment schedule shows any significant redemption of debt within the next 12 months which cannot be met from cash flow, details of how the redemption will be funded should also be provided.
 - i. Where a company, or the corporate group to which it belongs, will rely upon the revenue stream of a single asset or upon speculative cash flows, for example where assets are not yet in production, OGA will require adequate contingency funding arrangements to be in place to enable them to meet their licence obligations should the projected cash flows not be achieved.
25. The OGA is unable to issue consent for any assignment until the appropriate financial checks have been performed. To expedite matters, assignees may, if they so wish, send the required financial information in advance of receiving a formal request for the same from the OGA.
26. The requested information may be submitted in hardcopy or by email to:

Nic Rogers
Accountancy Adviser
Oil and Gas Authority
21 Bloomsbury Street
London WC1B 3HF

Tel: 0300 067 1627
E-mail: Nicholas.Rogers@ogauthority.co.uk

FINANCIAL GUIDANCE - FIELD DEVELOPMENT

27. OGA will not approve an FDP unless each company in a licence group that has an interest in the FDP, has demonstrated access to sufficient funds to meet its share of the actual costs with a reasonable contingency to cover cost overruns and other unplanned events. The level of contingency depends on the specifics of the case.
28. For the purposes of the OGA's assessment for offshore developments, the FDP Costs do not include future decommissioning as this is covered by separate guidance issued by DECC's Decommissioning Unit based in Aberdeen.
29. OGA's Financial Capacity criteria for FDPs is stricter than those applied at licence award or licence assignment in that each licensee has to demonstrate actual availability of cash resources to meet its share of the FDP Costs, not merely the capacity to raise the necessary cash.
30. An FDP will include both a detailed breakdown of the FDP Costs and, where there are several licensees, the licence equity split. Unless otherwise informed, OGA will assume FDP Costs for each licensee will be in accordance with their equity stake.
31. The licensee, or each company within the licence group that has an interest in the FDP, should individually provide evidence of the availability of cash resources to pay for its share of the FDP Costs.
32. Acceptable evidence of cash resources include, but are not limited to, bank statements, Parent Company funding and operating cash flows from producing assets.
33. If a company's evidence shows a deficit of liquid cash resources to meet its share of the FDP Costs, it should also provide additional evidence of the availability of third party funding upon which it can draw in order to meet its licence obligations. OGA does not wish to be too prescriptive in this respect but sources of third party funding could include:
 - **Parent company funding:** OGA would expect the corporate parent to provide evidence of the availability of adequate liquid cash resources to provide sufficient funds to its subsidiary to enable it to meet its share of the FDP Costs. OGA would also expect parent company funding to be formalised, for example by the provision of a parent company guarantee (if not previously provided) or inter-company loan agreement. Any parent company guarantee should be provided on the parent company's corporate stationery and use one of the two prescribed forms of words.
 - **Directors' or Shareholders' loans:** these must be confirmed in writing and the company must provide adequate evidence that the directors and/or shareholders have access to sufficient liquid cash resources to provide the necessary funds to the licensee.
 - **Loans from banks or other financial institutions:** These must be evidenced by a copy of the executed loan agreement signed by all parties. **Undertakings by a bank or other financial institution to provide loans or letters of intent are not acceptable.**
 - **Future cash flows:** from existing assets where those assets have proven reserves and are in production, and revenue can be shown to be independent of the FDP being considered. The licensee must demonstrate that the cash flows are sufficient to enable it to meet its share of the FDP Costs as they fall due.
34. If a company will be relying upon commercial debt to fund its share of the Costs, or is a subsidiary of a corporate group which is reliant upon commercial debt to provide its subsidiary with the necessary funds, OGA will need assurances that the funding arrangements will remain in place for the duration of the Field Development and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and any agreed capital repayment schedule. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment

schedule shows any significant redemption of debt within the next 12 months which cannot be met from cash flow, details of how the redemption will be funded should also be provided.

35. If a company, or the corporate group to which it belongs, intends to fund the Field Development from cash flows from assets that are currently in production, OGA will require detailed financial projections covering at least the period of development. These projections should comprise cash flow forecasts for both the company and consolidated cash flow forecasts for any corporate group to which it may belong. Any assumptions made in the compilation of these forecasts should also be provided.

DOCUMENTATION REQUIREMENTS

36. The required information may be provided in hardcopy or by e-mail.
37. The financial information may be provided with the application for FDP consent, or if appropriate with the application for drilling consent, or it may be sent separately to:

Nic Rogers
Accountancy Adviser
Oil and Gas Authority
21 Bloomsbury Street
London WC1B 3HF

Tel: 0300 067 1627

E-mail: Nicholas.Rogers@ogauthority.co.uk

FINANCIAL CAPACITY - WELL CONSENT: EXPLORATION and APPRAISAL WELLS

38. OGA's policy requirement is to ensure that no well consents are issued unless we are satisfied that the licensee(s) has(have) access to sufficient funds to meet its(their) share of the actual drilling costs, the plugging and abandonment of the well if it is proven to be "dry" or otherwise non-viable and a minimum contingency of 50% of the drilling costs. The sum of all these is referred to hereafter as the "Well Costs".
39. Additionally, S75 of the Energy Act 2008 added a provision to the Petroleum Act 1998 that grants to the Secretary of State the power to require financial information and documents from a company that has drilled, or started to drill, a well. OGA will analyse that information and decide whether or not it is satisfied that the company will later be able to plug and abandon the well. Where OGA is not sufficiently confident of this, OGA is empowered to require the company to take further action that will bring the necessary level of confidence, and while the action is not specified it might include the creation of financial security such as a Letter of Credit for the required amount under OGA's control. This power applies equally to all wells, whether onshore or offshore, drilled under a Petroleum Act licence or a Gas Storage Licence. OGA will routinely check the applicant's financial capacity in the context of considering a well consent. If not satisfied of the applicant's financial capacity OGA may be prepared to consent whilst making clear that we will invoke the Secretary of State's powers from the Petroleum Act if the applicant chooses to act on that consent and drill.
40. OGA's Financial Capacity criteria for well consents differ from those applied by OGA at licence award or licence assignment in that each licensee has to demonstrate actual availability of cash resources to meet its share of the Well Costs, not merely the capacity to raise the necessary cash. For example a company may have been awarded a licence on the basis that Commitment Cover was 2.00 or better so OGA was satisfied that it will be able to raise money to cover drilling costs when necessary. However when that company comes to seek a well consent, it will have to satisfy OGA that it has actually raised the money, whether from internal cash and bank balances or from external sources of cash.

INFORMATION AND EVIDENCE REQUIREMENTS

41. Each company participating in a well must provide a detailed estimate of its share of the Well Costs as defined in paragraph 1 above, and evidence of the availability of cash resources to pay for its share of the Well Costs.
42. Acceptable evidence of cash resources include, but are not limited to, bank statements, Parent Company funding and operating cash flows from producing assets.
43. If the evidence provided by any company shows a deficit of liquid cash resources to meet its share of the Well Costs, it should also provide additional evidence of the availability of third party funding upon which it can draw in order to meet its licence obligations. OGA does not wish to be too prescriptive in this respect but sources of third party funding would include:
 - **Parent company funding:** OGA would expect the corporate parent to provide evidence of the availability of sufficient liquid cash resources to provide sufficient funds to its subsidiary to enable it to meet its share of the Well Costs. OGA would also expect the provision of parent company funding to be formalised, for example by the provision of a parent company guarantee (if not previously provided) or inter-company loan agreement. Any parent company guarantee should be provided on the parent company's corporate stationery and use one of the two prescribed forms of words.
 - **Directors' or Shareholders' loans:** these must be confirmed in writing and the company must provide adequate evidence that the directors and/or shareholders have access to sufficient liquid cash resources to provide the necessary funds to the licensee.

- **Loans from banks or other financial institutions:** These must be evidenced by a copy of the executed loan agreement signed by all parties. **Undertakings by a bank or other financial institution to provide loans or letters of intent are not acceptable.**
44. If a company will be relying upon commercial debt to fund its share of the Costs, or is a subsidiary of a corporate group which is reliant upon commercial debt to provide its subsidiary with the necessary funds, OGA will need assurances that the funding arrangements will remain in place for the duration of the work programme and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and agreed capital repayment obligations.

DOCUMENTATION REQUIREMENTS

45. The information required under “Information and Evidence Requirements” may be uploaded to WONS or be sent separately in hardcopy or by email to:

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Oil and Gas Authority
21 Bloomsbury Street
London WC1B 3HF

Tel: 0300 067 1627

E-mail: Nicholas.Rogers@ogauthority.co.uk

FINANCIAL CAPACITY - WELL CONSENT: DEVELOPMENT WELLS

46. OGA will consider the cost of development wells during the FDP approval process. If the wells are not actually drilled within 18 months after FDP approval, OGA will apply its financial criteria separately during the well consent process.

INFORMATION AND EVIDENCE REQUIREMENTS

47. Where a significant amount of time has elapsed between the granting of FDP consent and the drilling of a development well each company of a licence group is required to provide the OGA with:
- An up-to-date estimate of its share of the well costs
 - Written or email confirmation that the funding arrangements it put in place at the time FDP consent was granted remain in place and are available for draw-down to pay for its share of the well costs
 - Evidence of the sufficiency of funding arrangements to meet its share of the drilling costs, for example a bank statement, a loan account headroom statement etc.
 - Full disclosure of any new funding arrangements which may have been put in place subsequent to the granting of FDP consent.

SUBMITTING THE DOCUMENTATION

48. The information required under “Information and Evidence Requirements” may be uploaded to WONS or be sent separately in hardcopy or by email to:

Nic Rogers
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Oil and Gas Authority
21 Bloomsbury Street
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Tel: 0300 067 1627

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